

Discussion of *Value destruction and wealth transfer under the IBC* by Pratik Datta

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IBBI-IGIDR Conference, New Delhi, August 2018

This is important work

- The paper asks fundamental questions about the IBC
- It goes to the root cause: what are the incentives of the various players?
- This is not incremental tinkering
- We need more work like this.

Claim 1: Value destruction owing to the power of secured creditors

- *Key idea*: If 75% of the CoC is secured creditors, and if they have no upside, and if the value of the collateral is good, then they will be biased in favour of liquidation.
- The solution is clear: The others should buy out the secured creditors.
The others are not just junior creditors, they could be shareholders too.
- If the IBC prohibits these side payments, that should be changed. (Does it?)

An interesting fact: There is a lot of secured credit in India! As SARFAESI came first.

- For historical reasons, SARFAESI came first
- IBC left the SARFAESI treatment of secured creditors intact.
- A very important question is: If we had to now rethink the treatment of secured creditors, what would we do?

Claim 2: A negotiation process prior to default

- *Key idea*: You can resolve through IBC but not before someone has initiated the IBC process. This is inefficient.
- I agree.
- Can a set of steps be orchestrated? A company makes the full plan through private negotiations, then strategically defaults on one person, then the CoC is setup, and the pre-designed deal is voted on in a day.
- Or alternatively, what deeper amendments to IBC would help?
- My article *Using the bankruptcy code for privatisation of state owned firms that have a negative value*, 1 July 2017, envisages such an orchestrated use of IBC for the purpose of privatising Air India.

Claim 3: Inadequate protection from abusive cramdown

- *Key idea*: The supermajority of the CoC can make decisions which harm others, and the NCLT is not authorised to block this.
- Yes, but.
- IBC was not designed for an ideal world with a well functioning legal system.
- IBC was designed to work optimally under Indian conditions.
- We now know a lot about how to build good courts in India.
- *Task force on establishing FSAT, 2014*: Separation of administrative and judicial functions. Use of modern computer technology in administrative functions.
- Sequencing: First build NCLT, then potentially we can think about addressing this problem.

Not convinced about the claim

- Consider equity and debt. The rules of the game are: If equity defaults, they get expropriated.
- Everyone knows these rules of the game, and they shape the valuation of equity and debt.
- It will be similar with secured and unsecured credit. If unsecured credit feels unsafe, they will charge more.
- If a homogeneous group of a super-majority of creditors emerges, and if they can harm the interests of others in a potential bankruptcy event, then the others will demand more.
- It is valuable and important to show these conflicts and to feed these back into the models used for pricing credit.
- I'm not sure the outcome is inefficient.

Conclusion

- An interesting and important paper (when it is written as a paper!)
- We should be asking such foundational questions about the IBC
- As these debates clarify, potentially there can be a broad consensus on the future evolution of the law.

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